

### **Testimony**



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Federal Credit and Insurance: Programs May Require Increased Assistance in the Future

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Before the Subcommittee on Oversight and Investigations Committee on Energy and Commerce House of Representatives



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#### Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to provide our perspective on the federal government's rapidly growing and wide-ranging credit assistance and insurance programs.

Federal exposure to potential risk from these programs—which range from defaults on guaranteed student loans and mortgages to making good on deposit insurance in banks and savings and loan associations—has risen dramatically in recent years. Only 2 decades ago, federal credit and insurance programs totaled just over \$400 billion. Today, that total is more than \$5 trillion.

While it should be emphasized that the government will face the obligation of making good on credit defaults or insurance guarantees in only a small percentage of this \$5 trillion exposure, the risk for very substantial loss is real. Losses from these programs have already cost the taxpayers tens of billions of dollars and have had a significant impact on the federal deficit. The most dramatic case, of course, is the cost the taxpayers will be forced to bear in making good on federal deposit insurance in failed savings and loan institutions. But the savings and loan crisis is only the most extreme example; we anticipate additional tens of billions of dollars in future losses in other programs.

At the same time--and this is more troubling--the government does not today know the full magnitude of the losses already

incurred, nor is it adequately prepared to foresee future losses that may well occur, as I will discuss in my testimony.

Against this background, I would like to highlight our November 1989 report<sup>1</sup> to you on the government's credit assistance and insurance programs.

### **BACKGROUND**

The federal government became involved with credit assistance and insurance programs to provide relief to individuals and businesses suffering losses during the Great Depression. Since that time, these programs have been greatly expanded to meet a number of the nation's vital social and economic needs. The programs fall into four categories: (1) direct loans of federal funds to borrowers, (2) privately held loans guaranteed by the government, (3) government-sponsored enterprise (GSE) loans, and (4) commitments for insurance programs, such as those covering bank deposits and pension benefits. Among the important results of these programs, home ownership has become far more widespread and educational opportunities have been greatly expanded. In addition, the Lockheed Aircraft Corporation, the Chrysler Corporation, and New York City were able to survive severe financial crises.

Federal Credit and Insurance: Programs May Require Increased Federal Assistance in the Future (GAO/AFMD-90-11, November 16, 1989).

## GROWTH AND SIZE OF FEDERAL CREDIT AND INSURANCE PROGRAMS

Federal credit assistance and insurance programs have grown dramatically in the last 2 decades, and have almost doubled in size since fiscal year 1980, to more than \$5 trillion as of the end of fiscal year 1988.

The most dramatic growth has occurred in the insurance and government-sponsored enterprise categories. From fiscal years 1965 through 1988, commitments on insurance programs rose 11-fold to \$3.6 trillion. About 75 percent of this total is insurance on deposits in the nation's banks and savings and loan institutions, and about 20 percent is pension insurance.

During the same 24-year period, outstanding loans by off-budget government-sponsored enterprises increased from \$15 billion to \$666 billion. Currently there are 11 GSEs, 5 of which were established in the past 3 years. Among the GSEs are entities such as the Federal National Mortgage Association, established in 1938 to provide a secondary market for home mortgages, and the Resolution Funding Corporation, which was created in 1989 in response to the savings and loan crisis. While the government expressly guarantees very little of the government-sponsored enterprise debt and mortgage-backed securities, the government's past willingness to assist the troubled Farm Credit System

indicates that it may again provide financial assistance to any financially troubled GSEs in the future.

Loan guarantees have also risen dramatically during this time frame, growing from \$91 billion to a reported \$550 billion. The Federal Housing Administration (FHA), which has been plagued by management weaknesses and billions of dollars in losses, represents over 50 percent of the loan guarantees.

While direct loan programs grew dramatically from fiscal year 1965 through fiscal year 1985, there has been a clear shift in this area. From a high of \$257 billion at the end of fiscal year 1985, direct lending declined to a reported \$222 billion at the end of fiscal year 1988. The Office of Management and Budget estimates a further reduction to about \$177 billion by the end of fiscal year 1994. In part, loan guarantees are replacing direct loans. Moving from direct to guaranteed loans reduces current budget outlays and, correspondingly, the reported current year deficit. Under present federal budget treatment, loan guarantees appear to have no cost in the year they are made. However, while shifting to loan guarantees does reduce that year's cash outlays, the shift does not necessarily represent a savings, and its treatment in the current year's budget masks the ultimate cost. The government will have to pay for any future quaranteed loan defaults, which will increase the deficit when the default occurs.

We have recently issued two reports discussing our proposal for the budgetary treatment of direct and guaranteed loans. We prefer an approach where, in the year the loans are made or guaranteed, (1) estimates are made of the ultimate cost to the government of making the loans or guarantees and (2) appropriations are requested to cover such future costs. We are now considering whether similar budget treatment is needed in insurance programs when premiums and fees are insufficient to cover costs.

## FEDERAL CREDIT AND INSURANCE PROGRAMS EXPOSE THE GOVERNMENT TO SIGNIFICANT LOSSES

Federal credit assistance and insurance programs put the federal government at risk for very large losses. Our intention is neither to imply that the government will be required to provide financial assistance for the \$5 trillion in total exposure associated with these programs, nor for that matter to project at this time what these losses will be. Nevertheless, this continuing and growing exposure to losses cannot be ignored. Huge defaults and losses have already resulted, affecting each category of credit assistance and insurance. These losses have added billions to the

<sup>2</sup>Managing the Cost of Government: Proposals for Reforming Federal Budgeting Practices (GAO/AFMD-90-1, October 1989) and Budget Issues: Budgetary Treatment of Federal Credit Programs (GAO/AFMD-89-42, April 10, 1989).

federal deficit, and large future losses are inevitable. The following are a few cases in point:

- -- Between fiscal years 1985 and 1988, loan write-offs increased from \$1.2 billion to \$21.2 billion. At the end of fiscal year 1988, reported loan delinquencies totaled \$19.5 billion.
- -- Between fiscal years 1983 and 1988, guaranteed loans terminated for default increased from \$4.7 billion to \$11.2 billion.
- -- Based on current estimates, the government's share of the \$257 billion savings and loan cleanup is expected to be \$139 billion.
- -- During fiscal years 1985 and 1986, the Farm Credit System (a GSE) lost \$4.6 billion which resulted in government guarantees and subsidized debt to enable the System to remain solvent.

### ACTUAL LOSSES HAVE NOT BEEN REPORTED

While some recent losses in individual programs have been the subject of intense publicity and scrutiny, the government does not today know the full magnitude of losses already incurred. As a

result of deficiencies in financial management systems and inconsistencies in the application of accounting principles by federal agencies administering credit assistance and insurance programs, many agencies have understated their current losses. Examples include the following:

- -- Our 1988 financial statement audit of FHA showed that the program (1) incurred about \$4.2 billion in losses in fiscal year 1988, not the \$858 million FHA initially reported, and (2) had an equity deficit of almost \$3 billion as of the end of fiscal year 1988, rather than the reported \$2-billion surplus.
- -- We reported that the Commodity Credit Corporation's financial statements do not fairly present its financial condition because the Corporation did not reflect an allowance for the uncollectible portion of outstanding loans, which we estimated ranged between \$5.6 and \$8.8 billion at the end of fiscal year 1988.

Until accounting and financial reporting problems are resolved and we have financial statement audits of all government credit assistance and insurance, we can only speak in terms of reported losses on these programs. The annual preparation and audit of financial statements are essential to provide independent

verification of the financial condition of these programs and will continue to be one of our priorities.

### FEES OR PREMIUMS INSUFFICIENT TO COVER GOVERNMENT LOSSES

One factor that influences the government's financial risk under its credit assistance and insurance programs is the amount of fees or premiums the government receives to cover its future costs. Fees and premiums vary significantly and, in a number of programs, do not recover program costs. This is sometimes by design, with some programs having legislative limitations on the amount they can charge. For example, although the Department of Veterans Affairs' Loan Guaranty Revolving Fund charges a 1 percent guaranty fee, it has required \$3 billion in additional funding to cover losses since fiscal year 1980, with \$900 million provided in fiscal year 1988 alone.

In other programs, serious problems in an industry or sector of the economy have resulted in huge program losses that cannot be covered by fees charged program participants. The Maritime Administration's (MARAD) Federal Ship Financing Fund is an example. MARAD charges a one-time investigation fee of one-half of 1 percent on loan amounts up to \$10 million and one-eighth of 1 percent on loan amounts greater than \$10 million. Since 1985, MARAD has reported annual operating losses ranging from \$195 million to

\$755 million. It has had to borrow almost \$2 billion from the Treasury over the last 3 fiscal years and in fiscal year 1987 received \$1.4 billion in supplemental appropriations to help repay those borrowings.

Whether fees or premiums on any specific programs need to be increased is a policy decision that requires detailed consideration of those programs' characteristics and objectives. Our goal is to create an awareness that, when fees and premiums are insufficient to cover program losses, the burden of providing financial assistance to keep programs in operation falls onto the government. Further, it is important that the Congress and the administration be fully aware of actual program costs, the amount of those costs being recovered through fees and premiums, the source of any financing being provided, and the amount of current and potential shortfalls.

In summary, as the Congress tries to deal with the deficit, it will be faced with significant losses from a wide variety of federal credit assistance and insurance programs. At this time, no one really knows how much those losses will be. Furthermore, because of long-standing problems in the way some agencies account for and report on these programs, the magnitude of losses already incurred by the government has not been determined. Federal

decisionmakers are already faced with painful decisions on the revenue and spending sides of the budget, and the decisions will be even harder if program losses in federal credit assistance and insurance programs continue to grow.

I believe it is important for the estimated costs of these programs to be reflected in the budget before the Congress makes the commitments that will result in future outlays. Also, periodic financial audits of the reported results of these programs would go a long way toward ensuring that actual losses are known as they occur. Finally, we strongly urge the passage of legislation establishing a Chief Financial Officer of the United States, and equivalent positions in the executive agencies, to provide the organizational structure and discipline needed to help ensure the integrity and completeness of reported financial information. For our part, we will continue to focus on reviewing the wide range of programs I have discussed today. For example, at the direction of Congress, we recently began a comprehensive study of the risks associated with GSEs, and we have a priority effort underway to review all facets of the savings and loan cleanup.

Mr. Chairman, this concludes my formal statement. I will be happy to answer any questions you or members of the Subcommittee may have.

# GAO Amounts Reported for Credit and Insurance Programs Since FY 1965

Dollars in billions					
Program	1965	1975	1985	1988	Percent increase 1965 to 1988
Direct loans	\$ 33	\$ 50	\$ 257	\$ 222	573
Loan guarantees	91	218	410	550	504
Government- sponsored enterprise loans	15	80	370	666	4,340
Insurance commitments	299	1,102	2,852	3,617	1,110
Total	\$438	\$1,450	\$3,889	\$5,055	1,054